GEO

Guyana Economic Opportunities

Position Papers and Commentary on the Results of Private Sector Consultations on the Guyana Investment Act

Prepared by:
Donald Lecraw

Submitted by:
Chemonics International Inc.

In association with:
Management Systems International, Inc.

To:
United States Agency for International Development
Georgetown, Guyana

Under Contract No. 504-C-00-99-00009-00
Strategic Objective 1: Expanded Opportunities for the Urban and Rural Poor

April 2001

TABLE OF CONTENTS

PREFACE

In early 2000, the Private Sector Commission requested assistance from the USAID/GEO Project in drafting a new Guyana Investment Code. The impetus for this exercise resulted from the October 1999 Presidential Summit with the private-business sector. In April and May or 2000, GEO Investment Specialist Dr. Donald Lecraw met with a wide spectrum of both private and public-sector representatives to discuss the need for and necessary components to such a code in Guyana. With the assistance of Legislative Drafting Specialist and Attorney at Law Mr. Brynmore Pollard, legislation, entitled the *Guyana Investment Act*, was drafted. From October to December of 2000, the private sector held a series of public forums both in and outside of Georgetown to review and discuss the proposed draft legislation. Many questions and several suggestions for modifications resulted from these consultations. The Private Sector Commission again requested assistance from GEO to respond to some the technical questions that arose and in developing position papers on four key issues: dollarization of the economy, thin investments, investment tax credits, and national treatment for foreign investors. This report was prepared by Dr. Lecraw and includes the four position papers in addition to Dr. Lecraw's commentary on the private-sector discussions.

I. POSITION PAPER ON DOLLARIZATION

A. Issues Raised

Many questions have been made about **Section 24: Foreign exchange accounts** and it pertains to the potential *dollarization of the economy.* These questions include: What is dollarization? How would it happen? What would be the impact? Pros and cons? The private sector does not have a clear understanding of the concept of dollarization of the economy. Would or could it happen in this instance? What would be the effect? Should or should not the provision be left in as is? If so why or why not?

The proposed Section 24 states:

Section 24: Bank Accounts. Existing and new Investors may open accounts in the currency of Guyana and in foreign convertible currency with any corporate body licensed to carry on banking business in Guyana under the Banking Act.

B. Definition of Dollarization

Dollarization is the use of a foreign currency, usually an internationally traded currency, along side or in place of the domestic "currency." Dollarization does not necessarily imply that dollars are the foreign currency involved. The most prevalent foreign currency in circulation in Laos, for example, is the Thai baht. Most usually in dollarization, the foreign currency (or several foreign currencies) fulfill one or more of the three traditional uses of currencies:

1. As a unit of account;
2. As a medium of exchange; and
3. As a store of value.

When this is the case, (some) prices may be quoted in the foreign currency (acting as a unit of account); the foreign currency is used in purchases/sales (acting as a medium of exchange); and the foreign currency is used in bank deposits denominated in the foreign currency or the foreign currency is simply held itself as a store of value.

The degree of dollarization is the ratio of foreign "currency" held by domestic entities/nationals to the total "currency" in circulation, wherein:

- Total "currency" = foreign "currency" + domestic "currency";
- Foreign "Currency" = foreign cash in circulation + domestic bank deposits denominated in foreign currencies held by domestic entities/nationals + foreign bank deposits in foreign currencies held by domestic entities/nationals; and

- Domestic "currency" = domestic cash in circulation + domestic bank deposits denominated in domestic currencies held by domestic entities/nationals + foreign bank deposits held by domestic entities in domestic currencies.

By this definition, if a foreign entity/national holds a foreign-denominated bank deposit in the domestic bank, this amount is not counted as part of dollarization. In theory, foreign bank deposits held by domestic/entities/nationals are not counted either as part of total currency or as part of the foreign currency in circulation. Data on foreign currencies in circulation, however, is usually not available, and hence is usually omitted from the calculation of dollarization.

C. Degrees of Dollarization

Some countries have complete (100%) dollarization. These countries do not have a domestic currency. Most usually countries that have 100% dollarization have the following characteristics:

1. Small in economic size;
2. Small in terms of population;
3. Most usually former colonies;
4. Maintain close ties to the former colonial ruler; and
5. Use the currency of the former colonial ruler.

In these countries, the domestic currency is the foreign currency. A small percentage of countries have no dollarization. In these countries, usually by law:

1. Bank deposits are only denominated in domestic currencies;
2. Prices must be quoted in domestic currencies; and
3. Foreign currencies are not permitted in sales/purchases transactions.

Countries that do not permit any dollarization often have foreign-exchange controls; their currency is not convertible into foreign currencies except through the banking system; this conversion is under strict control or supervision of the Central Bank; and their currency has no or little value outside the country.

Most countries follow an intermediate path. The most prevalent form of partial dollarization occurs when the Government permits bank accounts to be denominated in one or more foreign currencies. Enterprises and individuals use these accounts largely when they need foreign exchange for international trade or financial transactions for travel. These foreign exchange accounts are usually used for their convenience. They may also be used as a risk-diversification measure to ameliorate the effects of changes in the exchange rate on the value of their currency holdings or as a hedge against the depreciation of the national currency.

In most of these countries, particularly those that do not have high rates of inflation and/or substantial currency fluctuations, the domestic currency is used as a unit of account, a medium of exchange, and as a store of value by most of the people. Typically, the more open a country to international trade in goods and services and to international financial flows, the greater the degree of dollarization through bank accounts held in foreign currencies.

D. Dollarization: Popular Concepts

The current debate and controversy over dollarization revolves around the decisions of the Governments of a few countries to move toward explicit use of a foreign currency, most often the dollar, as a major, and in some cases the only, currency in their economy. To do this, the Government takes one or more of the following steps:

1. Explicitly links the domestic currency to a foreign currency and guarantees this exchange rate; i.e., guarantees that X units of domestic currency can and will be exchanged into the future into Y units of foreign currency;
2. Allows the foreign currency to be freely used as a medium of exchange, an unit of account, and a store of value; and
3. Recalls the domestic currency entirely and allows only the use of the foreign currency.

This move toward complete dollarization in these ways is but one of the ways that a country can dollarize its currency system along the spectrum of dollarization.

E. Costs and Benefits of Dollarization

There is an extensive literature on the costs and benefits of dollarization. A large part of the literature revolves around two issues:

1. The net costs and benefits of dollarization; and
2. The circumstances under which a country would on balance benefit from some form of dollarization.

The costs and benefits of dollarization are fairly well understood. The magnitudes of these costs and benefits, and the degree to which various factors influence these magnitudes are not yet well understood. Hence economists cannot say, "under the following circumstances . . . . dollarization would be beneficial on a net basis; under the following circumstances it would not."

1. Costs

Seigniorage. The first and most definite cost of dollarization is the loss of seigniorage from currency in circulation. Seigniorage is the implicit interest (value) the Government earns on domestic, national currency in circulation.

To see this concept, consider a country with no currency. The government then creates a domestic currency, the Domestic. To place the Domestic in circulation, the Government exchanges the Domestic for (pays for) goods and services provided by enterprises and individuals, i.e., the Government receives goods and services and the enterprises and individuals receive currency, the Domestic, or bank accounts denominated in Domestics. The currency in circulation can be viewed as an interest-free loan from the entities holding it to the Government.

Now consider a country as it dollarizes its currency. Dollars replace some or all of the domestic currency. The dollars must come from two sources: foreign borrowings that are exchanged for foreign currency, for example the dollar, or a current-account surplus, so that, on a net basis, dollars flow into the country. Consider borrowing first. If the country decides to use dollars as its currency, it can borrow those dollars from the U.S. government and pay interest on these funds in exchange for the dollars to use as its currency. In this case, cost is clear, since the foreign borrowing to obtain the dollars it needs to use as its domestic currency bears an interest rate. Similarly, if the country runs a net surplus on current account (so that on a net basis more goods and services have flowed out of the country than have flowed in), it can use the dollars that have flowed in on a net basis as a part or the whole of its currency in circulation. In this case, the country has exchanged the value of its net exports of goods and services for the dollars it uses as currency.

The cost of seigniorage is not trivial. If Argentina were to convert to a totally dollarized economy, the cost would be on the order of US$3 billion per year for the "right" to use US dollars as its currency. The cost of seigniorage depends, of course, on the amount of dollars in circulation.

Monetary policy. The government of a completely dollarized country loses control of monetary policy. The monetary policy of the United States becomes the monetary policy of the country. For example, if the U.S. decided to follow a tight monetary policy to drive up interest rates to cool off the U.S. economy, the dollarized country could not follow a different monetary policy: its interest rates would have to follow those in the U.S. If it tried to maintain a different monetary policy by selling government bonds (denominated in dollars) to increase the money supply and maintain interest below those in the U.S., the dollars would flow out of the country to the U.S. (where they could earn a higher rate of interest). This would defeat the policy immediately.

The correct monetary policy for the U.S., however, may not be correct for the dollarized country. This would impose a cost on the country. (The benefit for a country of losing control over monetary policy will be described below.) If the country has sufficient dollar reserves or if it can borrow dollars abroad, however, it can use fiscal policy to stimulate or cool down the economy. Monetary policy, however, is foreclosed to it.

Exchange rate policy. If a country guarantees to fix its exchange rate to a foreign currency or if it uses a foreign currency as its own currency, it completely loses its ability to undertake an independent exchange rate policy. (The benefits of this situation will be discussed below.) If the value of the foreign currency appreciates relative to other currencies, perforce the value of the dollarized country's currency will increase as well.

For example, the recent strength of the U.S. dollar has implicitly strengthened the value of all currencies fixed to the dollar and of the "domestic" currencies of all countries that have dollarized completely by using dollars as national currencies.

Using Argentina as an example again, as the U.S. dollar has risen (and particularly after Brazil devalued its currency against the dollar), the price of Argentina's exports have increased in terms of other currencies that are not linked to the dollar. At the same time, the prices of imports from these countries have fallen. This situation has retarded Argentina's exports and increased imports to the detriment of export-oriented industries and import-competing industries.

When the exchange rate of a dollarized economy rises with the U.S. dollar, in order to redress this imbalance the country must reduce wages, costs, and profits in trade-exposed industries. To the extent that wages, costs, and prices are sticky and do not adjust rapidly, there will be a recession. As Keynes wrote, it is easier and less costly to change the price of foreign exchange than it is to change the thousands of prices of goods and services and wages in the market.

The closer the economy of the country that has dollarized is in trade structure to the United States, the more probable is the coincidence of forces that drive exchange rates and hence the lower is this cost of dollarization. For example, this cost of dollarization would be high for an economy with heavy reliance on oil for exports. If there were no dollarization and oil prices fell, the exchange rate could devalue so as to increase non-oil exports; with dollarization, the currency cannot fall and real wages and other costs would have to be reduced, usually through a recession. If Quebec were to split off from Canada and became an independent country, but it retained the Canadian dollar as its currency, this cost of (Canadian) dollarization would be relatively low.

Similarly, the more closely the economy of the dollarized country is integrated with the United States through trade, the lower this cost, since its exports and imports are with the United States, and, for this trade, there would be less impact.[1]

The banking system. One of the functions of the Central Bank is to act as a "lender of last resort", largely to the banking system in times of crisis. In a dollarized country this lending would have to be in dollars. For the Government to be able to fulfill this function, it must have a store of dollars or a line of credit to raise dollars.

2. Benefits

Interest rates. The offsetting benefit to the cost of seigniorage is the reduced cost of borrowing for the Government and domestic enterprises and individuals. Usually when a country or enterprise wishes to borrow abroad, it borrows in dollars or some other major, internationally traded currency. This loan must be paid back in dollars. Hence the country

[1] The word "less" impact is used consciously here rather than "no" impact. As the dollar rises, U.S. exporters and import substitutors are impacted through their trade with other countries against whose currencies the dollar has risen. The dollarized country would feel this impact as well.

or enterprise faces an exchange rate risk. For example, if its currency devalues by 50%, it will have to raise 50% more funds in domestic currency to pay for the interest and capital repayment of its loan, the Government out of government revenues, enterprises out of cash flow.[2]

In a completely dollarized country, this exchange rate risk is eliminated. Borrowers do not face exchange rate risks vis-a-vis the dollar. Lenders in turn have a greater surety that their loans will be repaid. In response, they charge lower interest rates. This does not imply that the interest rates charged by lenders to the Government or to domestic enterprises will be equal to those in the U.S. The differential between interest rates for the country and for the U.S. government and for domestic enterprises relative to U.S. firms will reflect country risk and enterprise risk. There will be a decrease in the interest rate differential, however, since borrowers do not face a currency risk.

If the dollarized country still has retained its domestic currency, but has fixed it against the U.S. dollar, the Government, enterprises and individuals can usually borrow funds at a reduced interest rate since they are assured that they do not face exchange rate risks. This reduction, however, will be less in the case of a country with complete dollarization, since, even through the Government has guaranteed that it will not devalue the domestic currency against the dollar, it may feel forced to do so in certain circumstances. For example, the Thai government tied the baht to the dollar for decades.

Monetary policy. The cost of losing control over monetary policy can be offset by the imposition of the monetary discipline followed by the US (for the past two decades). US monetary policy may be inappropriate at times given the country's situation, but there is some degree of surety that it will not be reckless, get out of control, or be wildly manipulated for political purposes. This surety reduces the risks for enterprises, borrowers, and lenders when making investment, production, and borrowing and lending decisions. Since risk is reduced, there is a decreased cost of doing business and of obtaining funds.

Exchange rate policy. The benefit of complete dollarization relating to the exchange rate is that it reduces exchange rate risk and hence enhances international trade and investment, particularly foreign direct investment. With dollarization, a foreign investor does not run the risk of investing by converting dollars into the domestic currency, only to have the domestic currency devalue and reduce the U.S. dollar value of that investment. For example, General Motors invested almost $1 billion in Thailand just prior to the Asian Crisis. The dollar value of its investment was reduced by almost 40% because of the crisis.

It should be emphasized that with partial dollarization, many of these costs and benefits are reduced, even eliminated. The country can follow an independent monetary and exchange-rate policy; interest rate differentials do not fall, since enterprises and the Government receive revenue streams in domestic currencies. There is a cost to the

[2] This is one of the major problems facing enterprises and governments in Asia after the sharp devaluations during the Asian crisis.

Government in seigniorage to the extent that dollars replace the domestic currency, but this cost is often low.

F. Dollarization and Guyana

With this background, the central issue of dollarization and Guyana can be addressed. It is not the purpose of this position paper, however, to address the issue of whether Guyana would reap net benefits or net losses if it dollarized. Rather, the issue is whether granting investors the right to maintain dollar-denominated bank accounts would lead to dollarization or not.

By the definition above, if the Government allowed foreign investors to maintain foreign exchange accounts, this would not be dollarization, since dollarization pertains to domestic enterprises and nationals. As described in another position paper, however, to allow foreign investors to maintain foreign exchange accounts in Guyana's banks but not to permit Guyanese enterprises to do likewise would not only be unfair (an unequal, non-level playing field), it would be counterproductive and would decrease the efficiency of the economy. If domestic enterprises were allowed to maintain foreign exchange accounts, this would be dollarization by the definition given above. (If both foreign investors and domestic investors were prohibited from maintaining foreign exchange accounts, this would not violate a "national treatment" clause in the investment law since both sets of firms would be treated equally.)

If the Government, however, were to allow both foreign and domestic investors to maintain foreign exchange accounts, this would be far from the "dollarization" as described (both in praise and condemnation) in the popular press. As has been emphasized above, dollarization is a continuum, not an off-or-on situation. Allowing foreign and domestic investors to maintain foreign exchange accounts is only partial dollarization. Moreover, there is no reason that this partial dollarization would lead to further dollarization or "creeping dollarization", unless the Government explicitly permitted or fostered this trend. If the Government allowed inflation to get out of control and/or if the Guyanese currency were to fluctuate or fall significantly, however, then investors would move into dollars as a risk-reduction method.

Most countries allow investors (and private individuals) to maintain foreign-exchange accounts. This has not significantly impacted the countries' ability to have effective exchange rate and monetary policies or to act as a lender of last resort to the banking system, all major costs of complete dollarization. Canada and the Philippines, to take as examples two economies at different levels of development, have a significant degree of dollarization, as defined above, due to extensive use of foreign-exchange accounts by individuals and enterprises. Historically both countries have been able to follow independent exchange rate and monetary policies. They have also been able to intervene during financial crises to support the banking system as a lender of last resort. If Guyana were to allow investors to hold foreign-exchange accounts, the country would not bear the costs of loss of control over its exchange rate, or its monetary policy, or the Government's ability to intervene in times of financial crisis as a lender of last resort.

The major benefit if investors were to be allowed to hold foreign-exchange accounts would be in the increased efficiency of trade, financial flows, and investment due to decreased exchange-rate risks and decreased transactions costs. The only offsetting cost would be a very modest loss of seigniorage as investors held foreign-currency accounts, since, instead of converting their foreign exchange earnings into domestic currency, they could hold part of it in a foreign-currency account.

G. Recommendation

This provision in the proposed Investment Act should be retained.

II. POSITION PAPER ON NATIONAL TREATMENT

A. Issues Raised

The Draft Investment Act's **Section 18: National treatment** caused a lot of discussion. Some Guyanese believe that they are already receiving unfair treatment from other CARICOM countries, since Guyana has signed CARICOM Protocol 2 giving other countries national treatment, whereas other countries do not reciprocate with Guyanese investors in these same countries; e.g., Trinidad and Tobago. Questions include: How important is this? How common and necessary is national treatment? Could language on reciprocity be included?

The proposed Section 18 of the Investment Act states:

Section 18: National treatment. The Government shall grant national treatment to all Investors so that the Government shall treat Foreign Investors not less favourably than Domestic Investors and correspondingly shall treat Domestic Investors not less favourably than Foreign Investors.

B. Discussion and Recommendations

One of the major objectives of the proposed Investment Act is to give some degree of surety to foreign and domestic investors that government policy is in favor of private investment and that certain rights are protected by law. "National treatment" gives foreign investors the guarantee that they will be treated no less favorably than are domestic investors. As the section is worded, it also gives domestic investors the guarantee that they will be treated no less favorably than foreign investors. National treatment gives the most surety and comfort to investors on several dimensions:

- They will not be singled out for discriminatory action, e.g., expropriation based on nationality of ownership.

- If the Government decides to regulate private enterprise in some manner, it will have to extend this regulation to all enterprises and hence it may be less willing or able to carry out this action.

National treatment has far-ranging implications for both government and investors. If there is national treatment without any exceptions, among other activities, foreign investors have the right to:

1. Enter any industry that is open to domestic investors;
2. Own land;
3. Bid without discrimination on government contracts;
4. Borrow from domestic banks; and
5. Pay the same taxes on profits and dividends as domestic investors.

Granting national treatment without exceptions is also a difficult proposition for government or domestic investors to accept for a number of reasons. To follow the list above:

1. Government may want to reserve certain industry sectors for domestic investors, either because it feels that foreign investors can bring no value to the industry or for social reasons, e.g., preserving cooperatives or small service enterprises.

2. The government and the people may feel that the land belongs to the nation and should not be sold to foreigner investors.[3] Alternatively, there may be a fear that foreign investors, with access to plentiful capital, will outbid domestic investors and buy up major sections of the country's land.

3. Since the Government is spending national funds, the Government may feel that these funds should only be spent through domestic companies in its purchases.

4. Foreign investors have historically been seen as possessing capital as the major asset they can transfer into a country. If these investors are allowed to access domestic funds, the question is raised as to what benefits their investment will generate for the country. Moreover, foreign investors may be more creditworthy than domestic investors and domestic banks may give them access to funds that are denied domestic investors and/or charge them lower interest rates. Domestic investors may view this as an unfair competitive advantage for foreign investors.

5. Governments may want to tax foreign investors differently or at a higher level than they do domestic investors out of a belief that they earn higher profits or that they have a greater potential or ability to avoid domestic taxation through transfer pricing.

Granting national treatment to foreign investors is "best practice" among investment laws. As yet, however, few investment laws contain national treatment sections. Of interest, many of the investment laws of formerly communist/socialist countries do have national treatment sections. Three reasons have led to this circumstance:

1. These countries want to signal foreign investors that they are "open for business", especially foreign business.

2. Previously these countries had followed an anti-private enterprise, anti-foreign enterprise policy, and now they want to signal the radical change in this policy.

[3] There is a certain irony in this objection to national treatment. As noted in the discussions to the Investment Act, land is the one asset that foreign investors cannot take out of the country if they decide to stop operations and leave the country.

3. These countries generally have an urgent need for private investment to replace state investment and their domestic private sectors are weak.

4. The investment laws of these countries have generally been drafted within the last few years and hence it has proven to be easier to introduce best practice.

Even the United States *de facto* does not grant national treatment.[4] Under the Jones Act, internal shipping (on inland waterways) and between U.S. coastal ports must be on U.S. owned ships; there are restrictions on foreign ownership of airlines; and there are restrictions on foreign investment in U.S. defense contractors, to name a few of the important restrictions on foreign ownership.

In evaluating the efficacy of including national treatment in Guyana's Investment Act, several factors should be kept in mind:

- Most developing countries have some form of restrictions on foreign investment and do not have a national treatment section in their investment law. So, if Guyana did not have this section in its Investment Act, it would not be out of line with most other developing countries.

- The investment laws of all developing countries have been substantially and significantly liberalized over the past two decades as they have moved from restricting foreign investment to promoting foreign investment. These laws have moved closer and closer to national treatment over time.

- The U.S. government is said to currently require national treatment in the bilateral investment treaties (BITs) it is currently negotiating with developing countries. Most other countries require a most-favored nation (MFN) clause in any BIT they negotiate. Hence, if Guyana were to grant national treatment to U.S. investors, perforce this would be extended under MFN to all the other countries with which it has signed or with which it will sign a BIT.

Having said this, there is no overwhelming necessity or reason for Guyana to give absolute national treatment to foreign investors. Guyana, however, is not in a strong position in attracting foreign investment and it has a substantial need for foreign investment. Granting absolute national treatment would be a powerful signal to foreign investors that they would be welcome and would be protected. If the Government decides that absolute national treatment is too strong, it has two alternatives:

1. Grant national treatment with some exceptions or qualifications/conditions; or

2. Remove the section entirely.

[4] The United States does not have an investment law.

National treatment can be granted subject to exceptions. As examples, the section could read alternatively:

- "Foreign investors are granted national treatment except they are not permitted to own land."
- "Foreign investors are granted national treatment except for limitations in the XXX Act (or XXX Act and YYY Act.)"
- "Foreign investors are granted national treatment except as restricted by other laws."

The first alternative is preferable to the others. It spells out the exception clearly and there is only one exception. The second alternative is less acceptable. It contains more than one exception. The purpose of granting national treatment is to give comfort and assurances to investors. As the number of exceptions increases, the level of comfort and assurance of foreign investors decreases. The objective of an investment law and each of its provisions is to "keep investors' eyes focused on the donut, not the hole(s)." The third alternative is dysfunctional: it is vague and possibly filled with dangers for foreign investors. It raises the questions: what are all those (many?) other laws and what are their (many) restrictions?

Recommendation: The best choice would be to retain this section as is. If this is not possible for whatever reasons, either the exceptions should be limited to a maximum of three or the section should be removed.

The government and domestic investors have also expressed concern about "unfair" treatment vis-a-vis national treatment, especially from some other CARICOM countries. If national treatment were extended generally to all countries, the concern is that this unfairness would multiply. To address this problem, the suggestion has been made that a reciprocity clause be included in this section. Such a clause might read: ". . . shall treat foreign investors, except those whose home countries do not grant similar privileges to Guyanese investors . . . ." or "shall treat all foreign investors whose home countries grant reciprocal privileges to Guyanese investors . . . "

There are three reasons for changing this section in one of these ways:

1. A basic sense of unfairness: why should Guyana give investors from other countries this privilege when they do not give it to Guyana's investors? For example, it would be unfair in this sense if foreign investors in the construction sector based in one home country were able to bid on government contracts in Guyana on an equal footing with domestic Guyanese investors while Guyanese investors were not able to compete in this way in that home country. This is a specious reason. International economic relations are rarely based on this type of fairness. The relevant question is: is granting

national treatment in some form beneficial in and of itself to Guyana? If the answer is "yes," fairness should not enter the decision.

2. The government may hope that if national treatment is placed on a reciprocal basis, the Governments of other countries will grant national treatment to Guyanese investors. Alternatively, that a reciprocity restriction in the Act's national treatment section could serve as a bargaining chip in negotiations over national treatment for Guyanese investors in foreign countries. This rationale has more basis, to the extent that the Government believes that withholding national treatment is indeed a bargaining chip. It may be a bargaining chip with some small neighboring countries, but is probably not with most other home countries of potential investors. If this perception is correct, the Government has a problem. If a conditionality clause is inserted because of the actions of some CARICOM countries, it will have to be applied to all countries. As an example, since the United States *de facto* does not grant national treatment to Guyanese investors, Guyana would not be able to grant it to U.S. investors either.

3. The government may conclude that this section gives foreign investors a competitive advantage over Guyanese investors. If foreign investors can operate in both their home countries and in Guyana under national treatment, they might be able to achieve economies of scale and access lucrative government contracts at home that permit them to bid low on contracts in Guyana, gain regional brand recognition, preferred access to channels of distribution, and so on, all of which are not as readily available to Guyanese investors due to the lack of reciprocity in national treatment. This rationale is the most valid of the three. In a global economy, in many industry sectors foreign investment increases scale economies, spreads brand recognition, gives access to cost-effective raw materials and inputs, and so on. In these industries, Guyanese investors may need to invest abroad under the same conditions that foreign investors invest in Guyana in order to compete in Guyana. As with rationale #2, however, if the Government were to insert a clause requiring reciprocity, the cost of foregone investment might be high relative to the benefits to the Guyanese enterprise that would benefit if foreign governments were to grant them national treatment so as to allow their investors national treatment in Guyana.

Recommendation: On balance, the potential costs of including a reciprocity clause in this section would seem to be greater than any expected gain. Omit a reciprocity clause.

Concern has also been raised about the effect of granting national treatment to foreign investors and the ability of the Government to close sectors to foreign investment. Sections 4 and 11 limit foreign investors rights to invest in some sectors and their right to invest in other sectors with 100% foreign equity participation. These sections state:

- **Section 4: Fields of activity open to investors.** Investors may invest in and operate enterprises in all fields of lawful economic activity including in particular, but not limited, to agriculture, fisheries and forestry, manufacturing, energy, mineral extraction, handicrafts, communications and transport, construction, tourism, trade, financial and professional services, [except for sectors listed in Schedule A].

- **Section 11: Ownership regulations.** An Investment Enterprise may be wholly owned by either Foreign or Domestic Investors. There is no requirement that a Domestic Investor shall own any shares in any Investment Enterprise. [Notwithstanding the foregoing, the Government may reserve the right to own some or all of the shares in an Investment Enterprise operating in industries listed in Schedule B or as agreed under the terms of the relevant Investment Agreement concluded with the Government in relation to such Investment Enterprise.]

As described above, the Governments of most countries do not permit foreign ownership in some sectors and limit it to a specified maximum percentage in other sectors.[5] If Guyana included the phrases within the brackets in Sections 4 and 11 it would not be out of line with most other developing countries. At present, however, there are no explicit restrictions on foreign ownership in any sector of Guyana's economy: either restrictions prohibiting foreign investor or ones limiting it to a maximum percentage. This is a highly attractive feature of the investment system of Guyana. It places it at the forefront of best practice among investment laws in this area. All other developing countries are moving in this direction, but few have attained this position. If possible, complete openness should be retained.

If the Government decides to close specified industry sectors to foreign investment or limit foreign equity ownership to a specified maximum percent in other sectors, the best means to do so would be in attached "Schedules" to the Investment Act. This method will facilitate amending these schedules easily without opening up the Act itself to periodic revision. The schedules will comprise a "Negative List", the best practice means to restricting foreign investment.[6] If this method were to be followed, there should be an explicit direction for these schedules to be reviewed periodically (e.g., every three years) with an objective of removing sectors from the schedules.

Guyana is fortunate in that at present sectoral restrictions and equity ownership restrictions are not embedded in other laws. The experience in other countries is that restrictions on foreign investors embedded in other laws have proven to be difficult and time-consuming to remove.

[5] The best, in fact, not surprisingly the only, book-length analysis of foreign investment restrictions is Conklin and Lecraw, *Investment Restrictions in Ten Countries*, London: Croom Helm, 1996. This book is summarized by the authors in *Transnational Corporations*, 1996.

[6] The other means is to specify the sectors that are open to foreign investment with 100% foreign equity ownership or with limited foreign equity ownership and the conditions under which they are open. This is the so-called "Positive List" approach. Most developing countries have moved from a positive list to a negative list as they have liberalized their economies and opened them to foreign investment.

If the Government decides to restrict foreign equity ownership in some sectors, this action has implications for Section 18, "National Treatment." In sectors that are closed to foreign investment. but open to domestic investment, and in sectors in which there is a specified maximum foreign equity ownership, national treatment cannot prevail for foreign investors. In sectors which are closed to all private investment or in which private equity investment were restricted to a maximum percent (with the Government owning the remaining equity), national treatment could prevail since both domestic and foreign investors would be treated equally.

To repeat, the major purposes of including a national treatment section in an investment act are to give comfort to foreign investors and to send a strong signal that the country is "open for business" and has a strong policy to attract foreign investment. A national treatment section with many "excepts" does not accomplish these objectives. It highlights the "holes" of foreign investment restrictions and limitations to the "level playing field" between foreign and domestic investors, not the "donut" of a country open to foreign investment. To the extent possible, if a national treatment provision is to be included in the Investment Law, the "excepts" should be eliminated or reduced to a bare minimum. If this cannot be accomplished, then it is better not to include this provision.

There is another factor to consider concerning this aspect of the Investment Law: clarity for foreign investors. If there are restrictions on foreign investors, they should be clearly and explicitly stated. The Act should not state that all sectors or all sectors except specified ones are open to unrestricted foreign investment or open to foreign investment up to a specified maximum percent when *de facto* there are other investment restrictions in place. Foreign investors value certainty. If the Act states that a sector is not closed or does not have foreign equity restrictions, then this openness should be the case in practice as well as under the Act. For example, if the Act contains no restrictions on foreign investment in the transportation sector, then the investor should not discover that the Transportation Ministry will only issue an operating license to domestic investors or if the foreign investor has a domestic partner.

Recommendation: Retain the current open nature of the investment system of Guyana and do not close any sectors to foreign investment or limit foreign investment to a specified maximum equity percentage in specified sectors.

Recommendation: If the Government decides to place limitations on foreign investment in certain sectors, these sectors and the limitations should be clearly listed in attached schedules to the Investment Act.

Recommendation: If the Government does not formally restrict foreign investment in any sector, or if it includes schedules of sectors in which foreign investment is restricted, it must ensure that these schedules are complete so that the restrictions under the Act are congruent with those in practice.

III. POSITION PAPER ON "THIN" INVESTMENTS

A. Issues Raised

Many comments were made about How to handle *'thin investments,'* which is referenced in **Sections 3, 14, 24** and elsewhere.. There is a concern among many in the private sector and in the Government that Guyana could be taken advantage of by less-than-scrupulous investors who gain concessions but leave little in Guyana. The private sector wants to somehow guarantee that outside investors are serious. For this reason many in the private sector are against allowing foreign investors to borrow locally and want to ensure that they bring in capital from outside. Is the fear justified? What would be the impact on potential investors of not allowing borrowing from local banks. Are there other means to protect against unscrupulous investors and 'thin' investments?

These sections state:

Section 3: Government encouragement of investment. The Government encourages and seeks to facilitate persons, either individuals or legal entities, to invest capital in Guyana on the basis of mutual benefit and observance of the laws of Guyana and international treaties or agreements to which the State or Government is a party. Such persons hereinafter shall be referred to as "Investors" and their investments shall be referred to as "Investment Enterprises."

Section 14: Leasing and owning land. Investors may purchase or lease privately owned land and dispose of or transfer their interests in the land; Investors may also hold State lands by grant, lease or license from the State under the State Lands Act.

Section 24: Bank accounts. Existing and new Investors may open accounts in the currency of Guyana and in foreign convertible currency with any corporate body licensed to carry on banking business in Guyana under the Banking Act.

B. Discussion and Recommendations

There are three linked issues in this case:

1. Unscrupulous investors;
2. "Thin" investments; and
3. Access of foreign investors to capital through the Guyanese banking system.

Unscrupulous investors. At one time, many developing countries viewed all foreign investors with suspicion as archetypal representatives of capitalist, imperialist forces. More recently, this view of foreign investors has changed toward perceiving more value in most foreign investments than costs. In some countries there is a view of foreign investors as wholly good for the country. The truth, as usual, lies between these extremes. There are unscrupulous foreign investors who have ripped off host countries in the past and will rip them off in the future. This type of investor often preys on countries that are not experienced with foreign investors, have a great need for foreign investment, welcome foreign investment and grant incentives to foreign investors.

Ideally, the Government would want to keep this type of investor out of the country. Many governments require foreign investors to obtain a foreign investment license. The government then screens applicants for this license, among other things, to try to weed out unscrupulous foreign investors.[7] The question is: How can this be done in such a way as to weed out the few unscrupulous ones while at the same time not deterring or raising the costs of the many others? The more rigorous the screening process, the greater the cost to the investor and the deterrent effect of the regulation (and the cost to the Government in terms of administrative time consumed).

Strict investment screening processes increase the costs of investors and also increase the length of time required to go through the investment process. If there is strict screening, the potential profits of an investment project will have to be high in order for the investor to justify going through the screening process. At the extreme, a rigorous screening process may have a perverse effect. It may bias the system toward investors who plan to make high profits by ripping off the country; the others cannot justify the reduction in profits due to the costs of the screening process and do not even try to invest.

The development of the Internet has reduced the costs of checking the *bona fides* of potential foreign investors significantly, however. Foreign investors can simply be asked to provide references and the Government can easily and quickly check them in most cases.

A second way to address this concern is through other government regulations and their enforcement. Instead of screening investors under the presumption that some are unscrupulous, the Government can monitor their behavior in relation to what they have undertaken to do and the applicable laws. If, for example, the investor operates in the forestry sector and if there is a regulation concerning replanting, the Government can monitor the investor's behavior. Alternatively, the Government can require the investor to post a bond to cover replanting in the event that the investor harvests the trees and leaves the country. Some governments view investors as being unscrupulous who lease large tracts of land with the stated intension of developing it for some type of agricultural production when their real intension is to sell the leases in the future. If the Government does not view this type of investment with favor, provisions in the tax law can be used to recapture these gains.

[7] During this screening process, governments also usually try to screen out investments that they do not view as beneficial to the economy. This process is often ineffectual at best and has often proven to be an invitation for government personnel to engage in inappropriate administrative behavior. As an example of the former effect, a study by Louis Wells of Harvard Business School found that there was no correlation between whether the screening agency had accepted or rejected an investment and whether, based on a social cost benefit analysis, it yielded net benefits to the country from which the sample was drawn.

In general, the experience of developing countries has been that *ex ante* regulation to prevent unscrupulous behavior is less effective and more costly than *ex post* monitoring and regulation of investors' behavior.

Recommendation: At present Guyana does not screen foreign investors that do not request incentives. This procedure should not be changed.

"Thin" investments. There are two issues with "thin" investments: their size and the amount of capital they bring into the country. The second issue is tightly bound up with the issue of the access of foreign investors to the banking system and will be analyzed below. As a general proposition, all else being equal, host governments would rather not have foreign investors or foreigners *per se* involved in their economies. If a host country could efficiently and effectively replicate the assets that foreign investors bring to the host economy—capital, product and process technology, management, access to export markets and cost-and-quality-effective imported inputs—there would be no need for it to permit foreign investment. (Not coincidentally, if these conditions were present, there would be no desire by foreign investors to invest in the country).

Host countries incur costs when they permit foreign investment and foreign investors to enter the country. Foreign investment can increase the exposure of the domestic economy to global economic forces. For example, foreign investors that invest in a host country to access inexpensive labor can move their operations to other countries when labor costs shift or the real exchange increases more easily than can domestic investors. Foreign investors are often also seen as a threat to domestic SMEs. Foreign investment and the residence of foreign investors may also entail social costs through envy and reduced social cohesion, importation of foreign ideas, attitudes, practices, and cultures.

Many countries have restrictions on the minimum amount of investment required of a foreign investor to bring into the country. Some high-income countries, such as the United States and Canada, link obtaining resident/investor visas to bringing in more than a specified minimum amount of capital that is invested in a direct, not a portfolio, investment and whose investment creates at least a specified minimum number of new jobs for domestic nationals. Even in these capital-rich countries, the Governments perceive some benefit to capital inflows particularly when they are coupled with direct job creation, an on-going concern of most governments.

Recommendation: The Government should seriously consider some minimum amount of capital inflow, job creation, and possibly other conditions (see below) that an investor who is not a Guyanese citizen must fulfill before meeting the requirements of being classified as a foreign investor. This would either require modification of the definition of "foreign investor" in Section 1 of the proposed Investment Act or placing these restrictions explicitly in another section of the Act.

Domestic borrowing restrictions. The investment laws of some countries also contain restrictions on foreign investors borrowing in the domestic market. The objective of this Act, however, is to come as close to "national treatment" as possible, and this restriction would be a step away from this objective. Over the past decades, many developing countries have removed these restrictions. Nonetheless, foreign investors would not perceive Guyana as being far out of line or to be anti-foreign investment if it were to impose such a restriction.

There are several intertwined issues involved here. Access to domestic credit markets can increase the ability of foreign investors to leverage a relatively small equity investment into a much more substantial total investment. For unscrupulous investors this ability could increase the absolute and relative size of their "rip off" of the host country, if this is their intention. It also can allow small foreign investors to achieve a much larger total investment and possibly circumvent minimum size or other restrictions on foreign investors.

Two other factors may be behind these domestic borrowing restrictions, however. First, to the extent that the value of foreign investment to the economy is seen as the imported capital and foreign exchange that foreign investors bring with them, local borrowing may be seen to decrease this value. Four decades ago, the theme of one of the few best sellers ever written about foreign investment, *The American Challenge,* was that U.S. multinational enterprises had used European funds to buy up—and control—major segments of European industry. In a more modern viewpoint, however, the perception of the benefits of foreign investment stretch far beyond foreign exchange inflows. For this reason, the first rationale for restricting domestic borrowing by foreign investors has declined in importance.

The second rationale for this restriction revolves around the potential for preferential access and interest rates that foreign investors may be able to obtain from domestic capital markets compared to many domestic investors. With scarce domestic capital, domestic investors perceive this situation as giving foreign investors an unfair competitive advantage. They seen this as an instance in which equal laws (national treatment) can lead to unequal results in favor of foreign investors. For developing countries with a generally weak domestic private sector, this concern is real and legitimate.

The strength of this concern may be mitigated by one factor, however: the cost of domestic funds. As in most developing countries, the capital markets in Guyana, while improving and deepening over time, are not yet well developed. Bank deposits and banks in general are seen by the populace as more risky than those in high-income countries. Depositors demand a higher risk premium on their funds. This situation leads to higher interest rates for deposits than would be warranted given the rate of inflation and the real cost of capital. On the other side of the equation, the banking sector is not as efficient and is more concentrated than those in high-income countries. This situation leads both to higher costs for banks on the one hand and a greater potential for banks to set interest rates at will above the cost of their funds.

Taken together, these two factors have led to high borrowing costs on the one hand and a relatively high spread between the banks' cost of funds (the interest rate given to depositors) and the interest rate at which they re-lend these funds. Since foreign investors can access funds internationally where these two conditions do not exist, foreign investors will generally prefer to borrow abroad, often from their parent companies in their home countries through intra-corporate loans and supplier's credit from the parent company.

There is one motivation for investors to borrow domestically instead of internationally, despite the higher interest rate on domestic borrowing. If the investor's revenues are in domestic currencies but its debts are in foreign currencies (e.g., the dollar), it is exposed to exchange rate risks. If the real value of the domestic currency devalues sharply, its international debt denominated in dollars will rise in domestic currency, but it may not be able to raise prices and hence profits in the domestic currency by a commensurate amount.[8] If the investor loans are denominated in domestic currency, it is not exposed to this risk.

If a host country has experienced devaluations in the real value of its currency in the past or if such a devaluation is possible in the future, then any investor would want to protect itself from the exchange rate risk by borrowing domestically. A restriction on the right of foreign investors to do so would be unattractive to foreign investors and would impede and reduce foreign investment.

Recommendation: Although borrowing by foreign investors from Guyana's domestic banking system will most probably not pose a threat to domestic investors, if there is significant resistance by domestic investors or the Government to permitting foreign investors this access, in the interests of accelerating passage of the Act, this restriction should be explicitly stated in the Act.

[8] Devaluation of the real value of the currency is the issue here. This fact can be illustrated with an example using the U.S. dollar. If the host-country economy is inflating at 20% higher than the inflation rate in the U.S. and the exchange rate is devaluing at 20% per year, the real exchange rate is constant. In this example, the investors costs and revenues and hence profits are increasing by 20% per year due to inflation. The investor can therefore balance increased revenues against increased interest rate and loan repayment obligations denominated in dollars: its 20% higher profits balance the 20% higher payments in domestic currency it must make to repay the dollar obligations.

IV. POSITION PAPER ON TAX HOLIDAYS

A. Issues Raised

A final key point of discussion concerned **Section 40: Tax holidays vs. investment tax credits**. There was a strong counterproposal for a tax reduction or an investment tax credit instead of a tax holiday. Arguments against a tax holiday were that it causes distortions and may not attract investors anyway, that it leads to transfer pricing, and that at least as far as existing firms in the same sector, it results in unfair competition. One suggestion to avoid unfair competition is to allow a tax holiday for major expansions. There was a question whether other countries have tried an investment tax credit and what has been the experience. Which does or would attract more investors? And which would be easier to administer? What would be the pros and cons of the two types of tax incentives?

Tax holidays are covered in Sections 39 and 40 of the Investment Act:

Section 39: Investment priority categories The Government hereby establishes three investment priority categories detailed in Priority Lists as set out hereunder:

a) Priority Industries/sectors: a list of specific industries/sectors the Government considers make substantial contribution to the socio-economic development of Guyana;

b) Priority Areas: a list of specific geographical areas in Guyana that the Government consider are in urgent need of additional investment for development; and

c) Priority Projects: a list of specific, objectively measurable Investment Project characteristics, such as export-orientation, labor absorption, new and advanced product or process technology, that the Government considers will make a significant contribution to national socio-economic development.

Section 40: Tax holidays New Investment Enterprises that fall within one of the three Investment Priority categories shall be granted a tax holiday of five (5) years. New Investment Enterprises that fall within two or more of the three Investment Priority categories shall be granted a tax holiday of ten (10) years.

B. Discussion and Recommendations

There is an extensive literature on tax (fiscal) incentives for investors. It can be summarized as follows:

- All countries give some form of fiscal incentives to investors either at the national or at the regional (state, province, or city) levels.

- The importance to investors of fiscal incentives in making location decisions depends on investor characteristics. For example, they are more important for "footloose" export processors and less important for investors oriented to the domestic economy.

- Governments grant fiscal incentives in three broad categories:

  - Industry incentives targeted at investors in specified industries;
  - Regional incentives targeted at investors in specified geographical regions; and
  - Performance incentives targeted at investors with specified characteristics: export oriented, high technology, labor intensive; use domestic raw materials intensively, and so on.

- Overall, fiscal incentives are of only moderate importance in investment location decisions.

- Tax holidays are the most widely used form of fiscal incentive.

- There is a tradeoff in developing an incentives system:

  - On the one hand, the clearer, less discretionary and the more transparent it is, the more effectively it will be administered and the more effective it will be in attracting investor; and

  - On the other hand, the less discretionary, the clearer, and the more transparent is the incentives system, the less flexibility the Government has in tailoring incentives to individual investors in order to attract specific, valued investment.

- In general, best practice is for an incentives system to be clear, non-discretionary, and transparent.

This last point needs support, since it is fundamental to the way in which a government sets up its incentives system. Take an extreme case. A country's investment law might state, "The government may grant incentives to the extent it seems necessary to attract investment that is in the national interest." Such a law gives investors no clarity concerning the conditions under which they may receive incentives. It also gives them no clarity over the extent of the incentives they may obtain. The Government, on the other hand, has essentially total discretion in awarding whatever incentives it deems correct given the circumstances surrounding the investment. All investors will apply for incentives and all investors have every motivation to apply for the highest possible incentives. The government will have to treat each application on a case-by-case basis with essentially no guidelines of which investments to give incentives and which not, and on what basis the extent of the incentives awarded should be made.

A far superior model is to have clear incentives. The incentives should be clear in two respects: the conditions under which incentives are available and the extent of the incentives.

In theory, incentives can increase the overall *economic* welfare of the country under two circumstances:

1. When they reduce distortions in the market due to externalities, government regulations, or monopoly power.

2. When they are needed to attract value-generating investment from competitor countries.

The first rationale, to compensate for the efficiency-reducing effects of externalities, government regulation, or monopoly power could motivate the following incentives:

- Training incentives if workers and managers leave enterprises after receiving training in order to work abroad or in other domestic enterprises for higher salaries;

- Infrastructure development incentives if the investor invests in infrastructure that is shared by other investors or the populace as a whole;

- Labor incentives if the Government-set minimum wage (plus fringe benefit) legislation raises labor costs above the market clearing rate;

- Incentives for industry clusters if there are economies of agglomeration (in industrial clusters) that cannot be captured by any one investor;

- Incentives for high-tech investment if there are technology spillovers from one investor into the economy as a whole through learning by observing or worker turnover;

- Regional incentives if congestion and/or pollution externalities can be mitigated by regional dispersion of industry;

- Infrastructure incentives if investment in roads or public transportation relieve congestion; or

- Export incentives if government-imposed tariffs and non-tariff barriers to trade increase the cost of capital equipment, spare parts, or inputs or lowers the return on export-oriented projects relative to import-substitution projects.

When the Government grants incentives based on these circumstances, at least potentially, economic efficiency and value are enhanced and the economy is made more productive. Incentives for labor training, infrastructure development, labor costs, industry clusters, research and development, regional dispersion, and to reduce/eliminate duties on imported equipment, spare parts, and raw materials can yield net benefits to the economy.

The second rationale for granting incentives is the presence of incentives competition. This rationale contains an implicit assumption that the investment generates value for the country in excess of its opportunity cost. Under this scenario, the Government can enhance economic welfare by reducing the net benefits accruing to the country (to the Government) by granting incentives in order to attract additional investment.

To be value-increasing, however, the increase in the amount of investment due to these incentives has to be greater than the loss to the country from transferring the share of the value of the investment from the country to the investor. For example, consider an investment of 100 units that yielded net benefits to the country of ten units and to the investor of ten units. If the Government were to grant incentives equal to two units (so that investors receive twelve units), the country's share is reduced by two units, twenty percent, to eight units. Unless investment increases by 25% (to 125 units) due to this incentive, the country will lose economic welfare by granting the incentive. Proponents of investment incentives then must believe that the elasticity of additional investment to incentives is high. Yet, as stated above, on average, fiscal investment incentives are of only moderate importance in affecting locational decisions.

The difficulty of achieving net gains from incentives is compounded by the fact that most investors would have invested anyway, even if there were no incentives. For these investors, fiscal incentives represent a pure transfer from the country to the investor with no offsetting gain to the country.

Closely linked to the incentives competition rationale is another common rationale for incentives: to offset cost disadvantages in the host country relative to competitor countries. For example, if poor infrastructure increases costs for the investor, some countries grant incentives to offset these high costs. Note, however, that in this case the net value (distributed to the investor and the country) is already reduced by the higher cost (in the example, the high cost of doing business due to poor infrastructure) of the investment in the host country relative to other competitor countries. Hence there is a real danger in this instance of reducing the net benefit to the country to zero or even for it to be negative. Using the example in the preceding paragraph, if high costs due to poor infrastructure reduced the value of the investment from twenty units (split between the country and the investor) to sixteen units, the investor's share would have to be twelve units (in order to attract the investment), and the country's would be only four units.

In this case, the country would have to bear not only the cost of the incentive, two units, but also the costs due to its poor infrastructure. In this situation, a better strategy for the Government might be to act directly to improve the infrastructure to reduce costs rather than to compensate for high infrastructure costs through incentives. This conclusion is reinforced when the reasons for the existence of high-cost infrastructure are examined. Usually they are due to lack of government funding to invest in infrastructure. Yet if the

Government grants tax incentives to attract investment in this situation, its tax revenues are reduced so that it cannot address the root problem: poor infrastructure.

There is another value-increasing rationale for granting certain types of incentives. This rationale is based on two factors: economic equity and political and social value. A country may grant incentives for projects in poorer, more remote, or less politically stable areas to improve the economy in these areas for social and political reasons. Investments attracted by these regional incentives will not make as great a contribution to efficiency (and hence GDP) as would investment in other, more economically viable areas. Nonetheless, broadly defined national welfare (including equity, stability and social/political concerns) may be enhanced.

With this brief theoretical framework in hand, we can return to the specific concerns of the Government and domestic investors regarding incentives. Section 39 was framed for the following reasons:

- It gives investors clarity, transparency and certainty in the incentives they can access;

- It encompasses the three major categories of incentives: industry incentives, regional incentives, and performance incentives;

- It reduces government discretion in incentives-granting, eases the administrative burden, and reduces the time required to process incentives; and

- It reduces administrative discretion and reduces the latitude for inappropriate administrative behavior.

The government has expressed concerns that this section reduces the flexibility of its incentives-granting authority and its ability to tailor incentives to meet special circumstances. In this conclusion, it is correct: it does all of these things. The benefits listed above, however, would seem to offset these potential costs.

Recommendation: Retain Section 39 as is.

Concern has also been expressed by both the private sector and the Government over the income tax holidays granted in Section 40. There are many ways in which fiscal incentives can be formulated. As stated above, however, almost all developing countries offer some form of tax holidays. Investors have come to expect tax holidays, even insist that they are crucial to their locational decision. Based on these two factors, tax holidays were used as the primary fiscal incentive in the proposed Investment Act.

There are many problems with tax holidays, however:

- They are a "one shot", short-term fiscal incentive; once they have expired, there are no further incentives for continued operations or investment. This has motivated some investors to invest; operate during the tax holiday period; and, when it is finished to divest and move on to another country or another industry in the same country and invest again to access the tax holidays for new investment.

- They discriminate against additional investment by existing investors. Once the tax holiday period has expired, tax holidays give no incentives for further investment. Some countries have devised systems to address this issue. For example, "major" expansions are granted tax holidays on a *pro rata* share of profits. This method is cumbersome to administer, e.g., what is a major investment expansion? Should they apply to expansion of capacity or expansion of actual measured output? They also are only effective if the investment is for expansion, not for the reasons listed below in #3.

- They discriminate against investment in renovation, modernization, routine maintenance and upgrading of facilities, particularly if they do not lead to an increase in output. Guyana is in urgent need of this type of investment.

- They discriminate against investments with long gestation periods that do not come into production for a significant period after the investment is made. This problem can be addressed if the tax holiday period starts at the first year of full-scale production, or first year of profitability or the first year in which accumulated profits outweigh accumulated losses. These methods are prone to encourage tax avoidance by investors, however.

- They discriminate against capital-intensive projects that may operate with excess capacity and at a loss during the first years of operations.

For all these reasons, tax holidays are a very blunt, cumbersome, and ineffective means to give fiscal incentives to investors. Yet private investors value, seek, even demand them. They are the predominant form of fiscal incentives used by governments in developing countries. A substantially superior system of fiscal incentives would be based on the following elements:

- Extended loss carryforwards for tax purposes for a specified period; e.g., 5 years;

- Accelerated depreciation, investment tax credits, or capital cost allowances; and

- A uniform, low standard tax rate.

Such a system would have none of the drawbacks of a system centering on tax holidays. It would also be automatic and simple to administer. International experience also indicates that tax coverage and tax compliance increase as the basic tax rate is lowered. Most importantly, by adjusting the basic tax rate, it could be made as attractive to investors as a system involving tax holidays. This final point needs further elaboration.

Consider one tax system in which the basic tax rate is zero and compare it with a second one in which tax holidays are available, but, once they have expired, there is a high basic tax rate. Obviously, the zero tax rate system is more attractive to investors, i.e., it yields a higher net present value to the investor than the one with a tax holiday. Now, gradually raise the basic rate in the first system. At some point it will be equally attractive to the one with a tax holiday, i.e., it will yield the same net present value to the investor, as the second system.

Recommendation: Replace the tax holidays in Section 40 with other fiscal incentives as recommended below.

This recommendation immediately raises two issues:

1. The means by which the Government can engage in investment targeting in preferred industries, regions, and activities; and

2. The form these alternative fiscal incentives should take.

The fiscal investment incentives listed above typically apply to all investors, regardless of the industry or region in which they invest and their operational performance characteristics (export oriented, labor intensive, and so on). Yet, as described in the theoretical analysis above, in some instances the Government can increase economic welfare and investment by using fiscal incentives targeted at investors in certain industries or regions, and with certain operational characteristics. The more "repressed" (distorted) an economy, the greater is the value of using targeted incentives. This is especially important when import barriers in the form of tariffs and non-tariff barriers to trade give the economy an anti-export bias. In this case, it is not sufficient to remove these barriers for exporters (through duty drawback, or duty-free importation of capital equipment and inputs). These barriers raise the returns to import-substituting investment relative to export-oriented investment.

One means to target investors is to also have tax holidays for preferred investors. Alternatively, if tax holidays are rejected for the reasons listed above, the basic tax rate could be reduced for preferred investments. A few countries have done this by having two tax rates, one for promoted investments and one for all other investments. To have more than two basic tax rates can become cumbersome. As well, there may be problems if the government decided to remove certain investment projects from the promoted list and raises the question of whether current investors will have their taxes raised as well.

On the second issue, most countries allow loss carryforwards for tax purposes. Five years is a common period over which losses can be utilized to reduce taxable income. Accelerated depreciation, capital cost allowances and investment tax credits all reduce the investor's tax burden and act as incentives for investment. Different countries have chosen among these three alternatives to spur investment. Countries do not, however, use them simultaneously. If capital cost allowances are used, any form of depreciation or investment tax credit is not used. Similarly, if one of the other two methods is used, the others are not used. To use more than one of these tax reduction methods simultaneously would be "double dipping" by allowing more than the full value of the asset to be used to reduce taxes. This would bias the taxation system toward capital intensive investment and might lead to premature scrapping of capital equipment in order to obtain these double deductions.

Although accelerated depreciation, capital cost allowances and investment tax credits all serve to reduce taxation, they do not have the same impact on taxation. Accelerated depreciation increases depreciation expenses for tax purposes in the initial years of the investment and reduces them in later years. Lower taxes are paid in early years and higher ones in later years. Since funds have a time value, this is an incentive to investment. The depreciation schedule, however, is set in relationship to the economic life of the capital asset: short for assets with a short economic life, such as computers; and long for items with a long economic life, such as most buildings. Accelerated depreciation would simply shorten the economic life of capital assets across the board for all assets by a uniform amount.

Capital cost allowances also increase tax-deductible expenses in the early years of the investment and, for this reason, are similar to accelerated depreciation. Capital cost allowances, however, are often set without regard to the economic life of the asset. They tend to be uniform within asset categories; e.g., a truck and a machine tool would have similar rates of capital cost allowance since they are both classified as machinery (e.g., 25% per year for four years).

Investment tax credits are credits directly to taxes payable. They are not increased deductions from taxable income. These can serve as powerful, highly attractive investment incentives, especially if the full value of the investment is allowed to be deducted directly from taxes over time. With an investment tax credit, over time, the investor's tax liabilities are reduced by the amount of the investment. Over time, the Government ends up paying for the entire investment through reduced tax revenues. The only difference is that the investor pays up front and the Government "repays" the investor over time. Since funds have a time value, on a net present value basis, the investor does not recover all its up-front investment from the Government. With accelerated depreciation and capital cost allowances, the deductions are through increased expenses in the early years of the investment and hence reported taxable income. Accelerated depreciation only affects the timing of the tax, not its total amount.

To address this issue, some countries have instituted a hybrid system. The investor is granted an investment tax credit; e.g., 25% of "allowable" investment up front, and then the assets, minus the tax credit, are depreciated over time. This is quite a complicated and cumbersome system to administer.

Recommendation: Investor targeting via incentives should be done through reductions in the basic tax rate for preferred investors based on industry of investment, region of investment, and investment characteristics as determined by the Government. This should only be done, however, if only two basic tax rates are used: a lower one for promoted investments and another higher one for other investors. This lower tax rate should be applied to all investors, both existing ones and new investors in the future.

Recommendation: If the Government does not accept the recommendation above (due to the reduction of tax revenues from existing investors), then the Government should use investment tax credits in the first year of the investment of various amounts (depending on region, industry and investment characteristic), with these tax credits to be deducted from asset value for purposes of calculating depreciation in subsequent years.[9]

Recommendation: The Government should retain accelerated depreciation and loss carryforwards for tax purposes for up to five years.

[9] As an example, the Government could allow a 10% investment tax credit for specified industries; a 10% investment tax credit for investment in specified regions; and a 10% investment tax credit for investments with specified characteristics. These tax credits could be made cumulative, such that potentially an investor could receive a 30% investment tax credit.

V. Commentary on Private-Sector Discussions on the Draft Investment Act[10]

Investment Act

PART ONE: GENERAL PROVISIONS

Section 1: Definitions

In this Act -

"investor" means a natural or juridical person investing capital in Guyana on the basis of mutual benefit and observance of the laws of Guyana. "Investor" does not include "portfolio investor" for the purposes of this Act.

"portfolio investor" means an investor who owns not more than 5 percent of the equity or stock of an Investment Enterprise and does not have responsibility for the day-to-day management of the investment enterprise.

"investment enterprise" means an enterprise owned by an investor or investors.

"domestic investor" means:

(a) a citizen of Guyana;
(b) [any person, not being a citizen of Guyana, who is ordinarily resident in Guyana for a period of more than five years;]
(c) a citizen of any other member State of the Caribbean Community established under the Treaty done at Chaguaramas on 4th July, 1973;
(d) a body corporate established in a Member State of the Caribbean Community in conformity with the laws thereof and which is substantially owned and controlled by citizens of such a member state or by persons who are ordinarily resident therein;

"foreign investor" means an investor, not being a domestic investor;

"minister" means the Minister responsible for Finance.

Rationale: *Standard section to define terms*

Discussion: *(b) is not usual practice among developing countries. Its*

[10] Sections of the Act on which there was no disagreement, on which a consensus was reached, or that have been addressed in one of the position papers have been omitted. Commentary by and recommendations of the author are in larger bold font at the end of the section in question.

	inclusion was suggested at one meeting.

Consultant's Comment: Given Guyana's unique situation, I would agree with the inclusion of (b). There are two other provisions in this section that might be changed. As I read (c) and (d), they define citizens and corporate entities of these countries as being domestic investors. If the Government decides to place a "conditionality" on "national treatment," this will lead to confusion at best and internal contradiction within the Act at worst.

Guyana has a unique situation with so many Guyanese living outside the country as citizens of another country. Some countries, most notably the United States, do not recognize dual citizenship. Hence, if an adult Guyanese qualifies and applies for U.S. citizenship, he/she must give up Guyanese citizenship. If the Guyanese government recognizes this renunciation, then these former citizens are no longer citizens of Guyana. Yet they may possess funds, skills, and connections that would make them valuable investors. This situation may apply to their children as well, even those who have never held Guyanese citizenship. Consideration might be given to the possibility of defining these overseas Guyanese as Guyanese citizens for the purposes of this Act.

Section 3: Government encouragement of investment The Government encourages and seeks to facilitate persons, either individuals or legal entities, to invest capital in Guyana on the basis of mutual benefit and observance of the laws of Guyana and international treaties or agreements to which the State or Government is a party. Such persons hereinafter shall be referred to as "Investors" and their investments shall be referred to as "Investment Enterprises."

Rationale:	*Statement of overall Government policy toward investment that states explicitly that the Government welcomes investment, both foreign investment and domestic investment.*
Discussion:	*Both groups want to consider placing some sort of limits on who is defined as an investor and what is an Investment Enterprise, based on assets or employment. The purpose of this is to exclude micro foreign investors. It is recommended that a floor equivalent to US$50,000 be established.*

Consultant's Comment: I agree, although US$50,000 seems too low. In the Philippines, for example, the floor is $200,000, except for high-technology investments. Consideration should also be given to differentiate between foreign direct investors, and passive investors who "invest" in a bank account or in passive ownership in an existing enterprise in order to obtain an investor's visa. This could be addressed by explicitly stating that these investments must be new investments that create a specified number of new jobs for Guyanese citizens.

PART TWO: RIGHTS, GUARANTEES AND OBLIGATIONS OF INVESTORS

Section 16: Free export and import Notwithstanding the provisions of the Trade Act, the Government shall guarantee the rights of Investors and Investment Enterprises to import or export all or any products free of restriction or limitation except for products the ownership or possession of which is prohibited by law, except as listed in Schedule C.

Rationale:	*Again, this is an example of an important Section for inclusion in the Code having regard to the pervasive import controls that once existed in Guyana. Schedule C should be made as short as possible.*
Discussion:	*This Section may be problematic for the Government since exports and imports of a few goods are still subject to licensing. The export of certain types of logs is controversial. Moreover, Government may have problems with circumscribing its powers in the event of a balance of payments or trade emergency. Negotiation over some wording that would be acceptable to both sides is needed, possibly with the inclusion of a Schedule of products to which this section will not apply.*

Consultant's Comment: Schedule C allows the Government to restrict imports and exports of selected products. A provision for this schedule to be reviewed and revised periodically should be included. As well, a provision that automatically revises this schedule if a product is removed from the restricted list should be included.

Guyana has experienced balance of payments and balance of trade (BoP) emergencies in the past. Hopefully its current improved policies and procedures have eliminated this threat. WTO regulations allow emergency actions on imports by the Government in the event of BoP emergencies. One way to handle the problem noted above is to state that in the event of a BoP emergency, the Government will be bound by WTO regulations. There is a problem with explicitly highlighting BoP emergencies given what has occurred in the past and the Government's responses. To the extent possible, this should not be done, perhaps by citing WTO.

Section 19: Most Favoured Nation Treatment Without prejudice to rights conferred under International Treaties or Agreements, the Government shall grant Most Favoured Nation Status to all Investors and shall not discriminate among Investors on the basis of citizenship, residence, place of establishment or business ownership, or country of origin of any Investor.

Rationale:	*The purpose of this Section is to level the playing field for all investors. This is a fundamental principle for Investment Codes. Note that this section also takes into account Guyana's*

	membership in Caricom. This Section should be read in relationship to Article 149 of the Constitution.
Discussion:	*The Government has concerns about this section. Among other things, the Government is concerned that if it grants a right to investors from one country under a BIT, it will automatically be extended to all investors with whom it has BITs. On the other hand, BITs usually have an MFN clause in any event. It is recommended that the provision be retained. This Section is under policy advisement by the Government.*

Consultant's Comment: I agree with the recommendation that the Section be retained.

Section 20: Employment of foreign personnel Investors shall give priority to citizens of Guyana in recruiting and hiring their employees. However, investment enterprises have the right to employ skilled and expert foreign personnel when necessary and with the approval of the competent authority of the Government of Guyana in compliance with the Immigration and Labor Acts of Guyana. Investors have an obligation to upgrade the skills of their Guyanese employees through such techniques as training within Guyana or elsewhere.

Rationale:	*Most developing countries have this type of provision in their Investment Codes. It is designed to increase the employment generation of investment and to foster the development of the domestic workforce. The Government, usually the Labor Ministry, decides if Guyanese can adequately fill the needed position. Governments (and domestic citizens) seem impervious to the obvious argument that investors have every incentive to reduce costs by hiring locally and training domestic workers rather than hiring relatively expensive foreign personnel, unless domestic workers are not available. This Section does not give much comfort to investors. This Section is quite liberal compared to ones existing in some developing countries that impose numerical quotas on foreign personnel and/or phase down requirements.*
Discussion:	*No disagreement on the section as written. The private sector would like to have a tax concession of being able to deduct 150% of the costs of bona fide training courses for tax purposes in order to recover some of their expenses as personnel leave after they have received training. The Government is taking this under advisement. It is recommended that the provision be included, given the high turnover rate among skilled workers. This provision is not uncommon in other countries (or the Government gives training grants, as in Barbados).*

Consultant's Comment: Recommendation that the provisions be included. As described in the position paper on incentives, many governments give incentives for training in situations in which there is high labor turnover, especially if the trained workers leave for overseas employment.

Section 21: Entry and exit The Government shall facilitate the entry into, stay in, and exit from Guyana of Investors, their foreign personnel, and their immediate family members in accordance with the Immigration Act. All such persons are subject to and must obey the laws of Guyana while they are in Guyana.

Rationale:	*Obtaining visas is often a problem for foreign investors and for expatriate employees of all investors. This Section enjoins the Government to "facilitate" obtaining a long-stay visa for foreign investors and personnel and their families.*
Discussion:	*No disagreement as written. The Government requested that the words "travel within and stay within" in the original draft be deleted. It is recommended that "stay within" be re-inserted, since investors have concerns with obtaining the long-stay visas needed to own and operate Investment Enterprises and for visas for foreign personnel and dependants.*

Consultant's Comment: The "travel within" phrase was inserted since in some countries, travel to certain areas is restricted and/or requires a government permit. For investments located within those areas, these restrictions can present a problem. If Guyana does not have and has not had such restrictions, "travel within" should be retained to give more comfort to investors.

Section 23: Tax obligations Investors and their foreign personnel and foreign family members employed in Guyana shall pay to the Government personal income taxes in accordance with the Income Tax Act on income earned in Guyana and property tax and capital gains tax under the Property Tax Act and the Capital Gains Tax Act, respectively.

Rationale:	*This Section highlights the requirement that foreign investors, expatriate personnel and their families are liable for taxes on the income and capital gains they earn in Guyana and for property taxes if they own property. It also highlights the necessity for the Government to negotiate Double Taxation Agreements with major investor countries as a means of increasing investment.*
Discussion:	*No disagreement. Both groups, however, recognize that this is a*

significant impediment to foreign investors, but to tax them at a lower rate would not be politically feasible. This problem would be ameliorated if the Government were to undertake as a matter of priority negotiating double taxation agreements with major investor countries.

Consultant's Comment: The issue and how it might be addressed are more complex than indicated in the discussion. If both the Government and the private sector recognize that a lower tax rate should be given to foreign investors and their expatriate employees, but the electorate will not permit this, then there are several other alternatives and actions that might be considered.

The government recognises that if Guyanese taxes are levied on foreigners, investors and expatriate will engage in behaviour to minimize taxes paid in Guyana, regardless of the tax rate. A lower tax rate will reduce, but not eliminate, this behaviour. As examples, expatriates will be carried on the books of parent companies and enter Guyana on business visas and not pay any taxes; expatriates will be compensated with increased, tax-deductible benefits beyond the standard expatriate compensation package; expatriate wages will be understated and banked at home; and so on.

There is another consideration. Home countries tax citizens in different ways. In England, for example, if the person is out of the country for more than a specified period, income earned abroad is not taxable in England. In Canada, a citizen can fulfill certain requirements and declare himself/herself no longer resident in Canada and avoid any tax liability in Canada. For these persons, double taxation treaties (DTT) will not reduce taxes in the home country if Guyana levies taxes. U.S. citizens are taxed on worldwide income regardless of residence. For U.S. investors and citizens a DTT will have an impact.

The government might also consider allowing all investors to pay the taxes of their foreign personnel, have these payments as allowable expenses to the enterprise and not considering these payments as taxable income to the personnel. This would shift the tax burden as well as reduce it.

Section 25: Transfer of funds abroad Subject to the liability for the payment of all applicable taxes due, Investors may freely, unconditionally and without hindrance:

a) repatriate dividends, earnings and capital from their Investment Enterprises;

b) remit the proceeds in the event of sale or liquidation of an Enterprise or the interest attributable to an investment;

c) pay interest on international loans;

d) pay for imports;

e) pay fees for trademarks, royalties, and management and other fees; and

f) pay licensing fees for franchising agreements.

to their own home countries or to third countries through a corporate body licensed to carry on banking business in Guyana under the Banking Act.

Rationale:	*As with Section 24, this is an important Section and is standard in Investment Codes. It also highlights the fact that Guyana has a market-determined exchange rate, a major plus for investors.*
Discussion:	*The private sector supports this Section. Government may decide to take it under advisement. Part (a) contravenes the Foreign Exchange Act (that does allow the Government to block payments abroad). It also reduces the Government's ability to intervene during a foreign exchange or Balance of Payments crisis. It is recommended that this Section, suitably modified to address the Government's concerns, should be in the Investment Act, particularly given Guyana's past foreign exchange regime.*

Consultant's Comment: An attempt should be made to try to keep the modifications mild and to a minimum. Note, many studies have concluded that the right to repatriate profits and capital is highly prized by foreign investors.

Section 30: Obligations of investors to adhere to environmental, health, and safety laws Investors shall at all times conduct their operations in accordance with the laws of Guyana. In particular, Investors shall take all measures necessary and appropriate to ensure that the facilities, factories, products and activities of their Investment Enterprises protect:

a) the natural environment under the Environmental Protection Act; and

b) the health and safety of the workers and the general public under the Factories Act, Occupational Safety and Health Act 1997, the Accidents and Occupational Diseases Notification Act, and the Steam Boiler Regulations Act.

Rationale:	*Again, this is a standard provision in Investment Codes. Among other things, it centralises all the Laws in the country regarding the environment and health and safety.*
Discussion:	*There was some discussion from private-sector representatives*

	about relaxing these standards in duty free or export zones to attract investment. It is recommended that such a relaxation not be included.

Consultant's Comment: This section could be expanded to include consumer protection as well.

Section 35: Tax stability The Government hereby guarantees that corporation tax, capital gains tax, consumption tax, excise tax, and other duties and tariffs shall not be levied at a higher rate than those existing at the time of investment for a period of ten years or otherwise as contained in an Investment Agreement between the Investor and the Government.

Rationale:	*This Section gives investors the assurance that the fiscal system will not be changed for them over the next ten years. This reduces the risk of investment and enhances investors' ability to calculate the projected profitability (after tax) of their investments.*
Discussion:	*Both the private sector and the Government have some reservations about placing a ceiling on taxes, most particularly consumption taxes. Another issue is the probability that a VAT will be introduced. Both groups are taking this under advisement. It is recommended that consumption and VAT taxes be excluded from the tax ceiling. This section might also specifically exclude taxes and fees on timber, oil, and bauxite.*

Consultant's Comment: I disagree with these proposals for the exceptions. This provision is used very rarely in investment laws even though it would give comfort and surety to investors. Its deletion would not make a significant impact on the benefits of this Act as drafted. Better to delete the section than to highlight potential new taxes or increases in existing taxes.

Section 36: Inconsistency among laws and legal stability In the case of inconsistency or conflict between the provisions of this Act and other laws of Guyana, the provisions of the law most favourable to the Investor shall prevail.

Rationale:	*As described in the introduction to this commentary, one of the potential problems in Investment Codes may be conflicts between the provisions for investors in the Code and in other laws of the country. This Section assures investors that if there is a conflict, the Act most favorable to investors will prevail and take precedence. As well, under this Section, future laws would not necessarily have precedence over this one.*

Discussion: *This section has engendered considerable discussion. Among other things, it reads as if it supersedes the Constitution, which it obviously cannot. (This could be taken care of by a simple "except".) It also raises the issue as to who is the one to determine which provision is most favorable to investors. Also, it affects the legal principle that subsequent Acts override previous Acts. Most importantly, it restricts Government from prejudicing investors by, for example, enacting more stringent environmental laws. The Government is taking this Section under advisement. It is recommended that it be retained, if in modified form to address the concerns of the Government.*

Consultant's Comment: I cannot give an opinion about this recommendation without seeing the modifications necessary to "address the concerns of the Government." If they were extensive or involved many "excepts" it might be better to omit the section than to include it with the proposed modifications.

Obviously this Act cannot supersede the Constitution. It also cannot be enshrined so that it cannot be superseded by other laws. These are universal legal principles. The section does not state explicitly that it will supersede future laws, but this is the clear implication. Some countries have this provision in their investment laws to try to give investors clarity and surety. The wording does, at the very least try to clarify that the provisions of this law supersede any provisions in laws existing at the time of the Investment Act's passage. This, in and of itself, will have a positive effect on investors. This section should be retained with the additions, if the Government feels them necessary, of explicit "excepts" for the Constitution and future laws. Alternatively, this section should be changed to state that it supersedes all other existing laws except the Constitution.

The Government must be sure that it does indeed want the provisions of this Act to supersede provisions in currently existing laws. More importantly, it must ensure that government bureaucrats who function under other laws abide by the provisions of this Act in the case of a conflict. For example, if the Government decides to allow duty and tax-free importation of certain classes of capital equipment, then personnel in the Finance Ministry should not attempt to levy taxes or duties as prescribed under another law. This situation is apt to occur, especially when a ministry is judged by revenue-collection targets and the Act reduces these revenues.

As to who decides which law is more favorable to the investor, one would think that the investor would be the one best suited to know. This could be explicitly incorporated in this section with the phrase "as determined by the investor."

PART THREE: FISCAL INCENTIVES

Section 41: Tariff and consumption tax incentives Except for passenger vehicles, existing or new Investment Enterprises shall be entitled to import plant, equipment, spare and replacement parts for their sole and only use for a period of not less than five years free of all duties (tariffs), consumption taxes, and excise taxes.

Rationale:	*This is a very important Section. At present, much of the industry in Guyana uses old, outdated and inefficient plant and equipment. Also, many spare and replacement parts must be imported over very high tariffs and taxes. This has placed Guyana's industry at a severe competitive disadvantage both in export markets and in competition with imports. This Section addresses this problem. At present, duty and tax-free importation of some items is effected under a decision of Cabinet (or Ministerial Order?) dated December 1, 1998 [to be verified], and is done on a case by case basis. This Section also addresses this problem.*
Discussion:	*The Government is taking this section under advisement, since it limits its flexibility/discretion in determining which imports enter zero rated. This has revenue implications. All parties support it.*

Consultant's Comment: I strongly support it as well. If investors cannot obtain capital equipment and inputs at world prices, their ability to compete on world markets and with imports will be reduced.

PART FOUR: ADMINISTRATIVE STRUCTURES AND PROCEDURES

Section 45: Role of Go Invest Go Invest shall be the Governmental organisation with responsibility for administering the fiscal incentives investment system. GO Invest shall provide investors with all forms necessary to apply for incentives; assist investors in filling out these forms; and check the forms submitted by investors for completeness and accuracy.

Rationale:	*This Section clearly specifies Go Invest as the first point of contact for investors desiring to receive incentives. It reinforces Go Invest's role as an investment facilitator.*
Discussion:	*The government is currently considering revising the enabling law for Go Invest. This will have implications for all the Sections in Part Four.*

Consultant's Comment: The government might take these sections as well as the role of Go Invest as given in this proposed Investment Act into account when drafting the revision of the enabling law for Go Invest. The government should draft the new enabling law for Go Invest to be congruent with this Act, providing, of course, that the Government is satisfied with this Part of the Act. Changes to this part and to the enabling legislation should be done in relationship to each other.

Section 46: The Investment Promotion Committee The Government shall establish a Committee to be called the Investment Promotion Committee. The members of the Committee shall be composed of one representative of GO Invest, and one representative each of the Tax and Customs departments of the Ministry of Finance, representatives of the Ministries of . . . . and a representative of the private sector. The Minister of Finance (or the Minister's representative in the Minister's absence) shall be the Chairperson of the Committee. The Committee shall:

a) develop the three priority lists: the Priority Industries/Sectors list, the Priority Areas list, and the Priority Projects lists specified in Section 39;

b) in consultation with concerned ministries, develop Schedules A, B, and C and revise them on a regular basis as conditions warrant.

c) on a yearly basis modify and update these lists and propose these revised lists to the President for signification of his/her approval;

d) determine the fiscal incentives to which each individual Investor or Investment Enterprise that has applied for the grant of fiscal incentives is entitled;

e) make recommendations to the President concerning the fiscal incentives to which each individual Investor or Investment Enterprise is eligible for his her/his signification if the Investment is greater than $XXXX or in the mining, petroleum or forestry industries;

f) for all other Investments, to reach a binding decision concerning the Investor or Investment Enterprise's eligibility for incentives;

g) make recommendations on the types and unit volume of imports which shall be entitled to fiscal incentives both for the initial investment and on an on-going basis requested by Investors and Investment Enterprises; and

h) in highly exceptional circumstances as determined by the Committee, recommend incentives to be provided to Investors or to Investment Enterprise that are not on any of the Priority lists and/or recommend incentives beyond those contained in Sections 40 to 43 inclusive.

Rationale:	*This is an important Section. It spells out the procedures for developing the priority lists and in awarding incentives. It also gives the Government some latitude in awarding incentives "in highly exceptional circumstances" to give it the flexibility to deal with unusual investment projects. The President of Guyana will have ultimate signing authority over incentives.*
Discussion:	*There is considerable controversy over the composition of this Committee. Some parties want all the responsibility to rest with Go Invest except for large projects and those in sensitive sectors, such as timber, mining, and energy. This issue is under policy advisement.*

Consultant's Comment: Dual procedures and structures for awarding incentives based on industries and the size of the investment are common in investment laws. Investors, particularly those in sensitive sectors, would not be deterred by such a provision, would they have encountered them before.

Section 47: Time limitations for deciding eligibility for incentives Except for an Investment exceeding in value [US$ 10,000,000] and in the forestry, mining and energy sectors, the Investment Promotion Council shall render a decision on the eligibility of the application for incentives for the Investment Enterprise within fifteen (15) working days. If a decision regarding approval for incentives has not been rendered within this period, the Investment Enterprise shall be deemed to have been granted the incentives for which it has applied.

Rationale:	*This Section is important since it sets a time limit for granting incentives, except in the forestry, mining, and forestry sectors, sectors in which more detailed analysis may be necessary, and for large projects.*
Discussion:	*The Government is taking this Section under advisement due to both the time factor and the automatic grant feature. It is recommended that the Section be retained as is.*

Consultant's Comment: The time factor can and should be changed if the administrative bodies that will grant the incentives feel that it is too short. It is better to have a longer period specified in the Act and beat it in 90% of the cases than to have a shorter time period and miss it 10% of the time. The automatic feature was included to give the Government personnel involved "a sense of urgency." Some other investment laws try to achieve the same effect by granting investors the right to sue to recover the additional costs that any delays beyond the specified period entail. In accordance with the manner in which the incentives system is set up in the previous Part, incentives granting for most investments will be more of a check list than of an evaluation. This

should reduce the time required to process incentives applications for most investments.

Section 48: Timeframe for approval of incentives for zero rated imports For Investment Enterprises that have been granted eligibility for incentives, the Investment Promotion Committee shall approve the list of plant and equipment, spare and replacement parts required at the time of investment and in subsequent years over the life of the investment. If applicable under Section 43, Investment Enterprises may import raw materials, semi-finished, and semi-processed inputs at the time of investment and in subsequent years that will receive incentive duty and taxation rates. The process for approval shall not extend beyond twenty (20) working days after submission. If after 20 working days, approval has not been granted, approval shall be deemed to have been granted.

Rationale:	
Discussion:	*The government is taking this Section under advisement both for the time frame and for the automatic granting of incentives if the deadline is not met.*

Consultant's Comment: Same comments as above on Section 47.